Romania RIA Knowledge Transfer and Capacity Building Program

Summary of Consultation Feedback

Consultation Period	Start: 28.06.2007	End: 11.10.2007
Consultation Meeting	09.10.2007 Venue: The National Bank of Romania	

Name of regulation	Regulation no. 3/2007 on restriction of the credit risk on credits granted to individuals

Participants to the consultation process
Consumers
Commercial Banks
Non-bank financial institutions

The Romanian regulators are participating in an initiative organized by World Bank's administered *Convergence Program*. The purpose of this initiative is to strengthen the participants' ability to use the disciplines of impact assessment (IA) in order to improve the way in which policy is made. IA does this by requiring policy makers to use evidence and economic analysis to justify and explain their proposals. Consultation with stakeholders is a key part of the IA process because it promotes public accountability and provides stakeholders with the opportunity to contribute to the evidence base that should underpin the policy making process.

The participants of this knowledge transfer and capacity building program are the following: National Bank of Romania, Prime Ministry's Unit, Ministry of Economy and Finance, National Securities Commission, Insurance Supervision Commission, Commission for Supervision of Private Pensions System and National Authority for Consumer Protection.

This IA training exercise involves the work group undertaking a retrospective IA on an existing piece of financial regulation. In this case, the financial regulation is *Regulation no. 3/2007 on restrictions of the credit risk on credits granted to individuals*.

One part of the Impact Assessment Exercise on the above mentioned regulation is represented by the **consultation process** which consists in gathering the opinions of all the key stakeholders affected by this piece of regulation.

The working group prepared a Consultation Questionnaire (annex 1) and sent it to the stakeholders.

The questionnaire is designed to provide evidence relating to:

A. The nature of the **problem** that the regulation is seeking to address; and

B. The costs and benefits incurred to banks and consumers taking into consideration **four options**.

<u>A. What is the problem?</u>

There are two distinct elements to be considered:

a) the repeal of the 2005 regulation, and

b) the introduction of the 2007 regulation.

The 2005 regulation needed to be repealed because of EU competition. Instead 2007 regulation was introduced in order to manage potential market failure consisting in not properly managing credit risk and to ensure financial stability.

The stakeholders agreed that the **problem** was the one mentioned above but they raised some issues:

- the new regulation does not create a free competitive market for credit institutions;
- benefits to consumers seemed not to be taken into consideration.

Regarding the possibility that the policy concerns that gave rise to the 2007 regulation **would have been corrected by the market in the short term**, stakeholders' opinions are the following:

- The market would have corrected some of the concerns, but it is hard to estimate if this would have happened on short term or medium term.
- An intervention was needed, but the way the 2007 regulation approached the issue was not appropriate.
- Credit restrictions, such as imposing maximum credit limits have unintended consequences on the financial market, and, consequently, a negative impact on consumers.
- Credit restrictions limit the growth potential, and more seriously, affect low income people capacity of dealing with some temporary difficulties, when they need relatively small amounts, on short term.
- Maintaining lending restrictions considerably affects the process of credit sector liberalization and does not lead to the results expected. As mentioned above, concrete data show that economies without credit restrictions operate more efficiently than the ones where such restrictions exist.

B. The four options

I. Do Nothing Option - Maintaining the provisions of Norms No. 10 of July 27th, 2005 on mitigation of the credit risk related to credits granted to individuals;
II. Option 1 – The new Regulation no. 3/2007 on restriction of the credit risk on credits granted to individuals.
III. Option 2 - Self Regulation (e.g. A Voluntary Code elaborated by Lenders Professional Association)
IV. Option 3 – Bring amendments to Norms no. 10 / 2005 in order to keep uniform limits at the level of all financial institutions, but at the same time, adjusted to different categories of consumers (incomes)

I. Do Nothing Option - Maintaining the provisions of Norms No. 10 of July 27th, 2005 on mitigation of the credit risk related to credits granted to individuals.

Costs to regulated banks

The implementation of the old norms had some unintended consequences that caused distortions on the market:
- Lending on longer terms (to ensure that the monthly repayment rate is under the maximum limit), with a negative impact credit risk;
- Bureaucracy - reference point 100;
-Asymmetric impact – especially on NBFIs – some are treated like banks;
- Some market segments (low income) could not be served;
- Limited offer for high income market segments.

Benefits to regulated banks

Theoretically, there was a lower credit risk because of the maximum indebtedness levels, but has to be taken into consideration that banks did not report positive information.

Market impact

This option created an unfair competitive environment for NBFI's, who were treated like banks, even though they can not be compared to banks in terms of assets (NBFIs are not allowed to attract deposits) or in terms of portfolio of products.

- Quality of products offered:
    - ❖ Banks: low
    - ❖ Consumers: low
- Variety of products:
    - ❖ Banks: low
    - ❖ Consumers: low
    - ❖ NBFIs: low
- Efficiency of competition:
    - ❖ Banks, Consumers, NBFIs: low

Costs to consumers

- Limited consumers' access to lending; - A shift of costs from interest rates to loan fees and commissions;
- Favored lending on longer terms, which increased the costs for the consumers;
-Low income consumers were excluded, which encouraged illegal lending;
- Low competition meant higher costs to consumers.

Benefits to consumers

- The lending limits could protect consumers against over-indebtedness:

- Banks: No, as long as there is no nationwide database
- Consumers: Yes
- NBFIs: Yes

Unintended consequences

- Negative consequences:
    - Limited the access of consumers to mortgage loans (the regulated 25 % downpayment)
    - Limited the access of medium and high income customers to loans with higher value.
- The unintended consequences of the old and current credit restrictions in Romania are:
    - Lending on longer terms, with a negative impact on costs and credit risk
    - Financial exclusion of low income categories
    - Anti-competitive market.

Impact on competition

- NBFIs should not be subject to the same regulations as banks, as they do not compare to banks in terms of assets (NBFIs are not allowed to attract deposits) or in terms of portfolio of products.

Social impact

- Categories of consumers on low income are financially excluded, which could encourage illegal lending.
- Prices of houses could not increase too much, because customers were not able to access large value loans.

II. Option 1 – The new Regulation no. 3/2007 on restriction of the credit risk on credits granted to individuals.

Costs to regulated banks

- Compliance costs (elaboration of internal norms, IT costs, training and personnel costs, validation costs):
    - ❖ Banks: 21.800 EUR
    - ❖ NBFIs: 43.200 EUR.
- Bureaucracy – 200 (one-off); 100(ongoing).

Benefits to regulated banks

- More responsible lending.
- Risk management improved.

Market impact

- Quality of products offered:
    - ❖ Consumers/NBFIs: medium
- Variety of products:
    - ❖ Consumers/NBFIs: low
- Efficiency of competition:
    - ❖ Consumers: medium
    - ❖ NBFIs: low

Costs to consumers:

- ❖ Limited consumers' access to lending (for customers with monthly income below 350 EUR and supporting a family of at least 3 members)
- ❖ Difficulties when comparing the credit offers
- ❖ Lending costs will increase (due to implementation and compliance costs)
- ❖ Lower income consumers will be disadvantaged because of taking in consideration the deductible expenses (living)
- ❖ Meal tickets are not considered as a part of the monthly income, even if these instruments are fully regulated.
- ❖ Consumers would need to use more resources (time, the documents needed to obtain the credit could vary very much form one bank to another, own rules of banks could become stronger) in order to gather information and to obtain the credit.
- ❖ Banks will probably try to compensate the shrinking of the customer base with higher fees/commissions (not necessary higher interest rates) applied to loans.

Benefits to consumers:

- ❖ Improved access to lending for certain categories of consumers;

- ❖ Wider range of products.

Unintended consequences

- ❖ It will take time for consumers to familiarize with the new rules.
- ❖ Low to medium income customers will get no or less credit than under the previous regulations. Prices of houses may increase.
- ❖ Significant distortions in the market due to:

- timing differences between the registration of certain NBFIs with the Special Register (and hence the application of the crediting constraints);
- the existence of two level of supervision for different players (those in the Special Register and those in the General Register)
- the existence of other passporting EU firms which do not fall under the NBR supervision.

Impact on competition

- ❖ On one hand it would increase competition between Romanian credit institutions, on the other hand, it would determine the distortion of competition between Romanian credit institutions and other passporting EU firms which are not subject to the regulation.
- ❖ NBFIs shall no be subject to the same regulations as banks, as they do not compare to banks in terms of assets (NBFIs are not allowed to attract deposits) or in terms of portfolio of products. The current regulations are discriminatory also because NBFIs in the Special Registry have to comply with stricter rules that those in the General Register. The passporting rules are likely to increase unfair competition, because credit restrictions do not apply to the NBFIs set up in Romania by credit institutions based in other EU countries.

Social impact

- ❖ The over indebtedness of certain customers, bad debts followed by debit execution.

III. Option 2 - Self Regulation (e.g. A Voluntary Code elaborated by Lenders Professional Association)

<u>Costs to regulated banks</u>

- Compliance costs to regulated banks.
- Significant resources (people, systems, processes) engaged in the elaboration process, that will be reflected in credit costs.
- For responsible lenders, lower costs than implementing mandatory legal provisions – this is already a benefit

<u>Benefits to regulated banks</u>

No estimation provided.

<u>Market impact</u>

- Quality of products offered:
  - ❖ Consumers, Banks: medium
- Variety of products:
  - ❖ Consumers, Banks: medium
- Efficiency of competition:
  - ❖ Consumers, Banks: medium

<u>Costs to consumers:</u>

- ❖ Lending costs could increase, but, at the same time, if competition increases, then this could be surpassed.

<u>Benefits to consumers:</u>

- ❖ Diversity of products.
- ❖ A more customer oriented approach may be taken, more related to credit risk assessment and credit behavior.

<u>Unintended consequences</u>

- ❖ Distortion of competition: lowering the level of protection of consumer against over-indebtedness;
- ❖ Loan values can be adjusted according to the individual income and risk management;

- Some banks may risk too much, breaking responsible lending practices, in order to gain market share at any cost;
- Regulation in itself is not 100% effective in preventing companies from breaking or bending the rules. If NBFIs agree to a strong code of practice, there is actually less chance of an individual company breaking it. A code of practice could cover all NBFI's.
- Romanian market and consumers are not prepared for a Self Regulation at the moment.

Impact on competition

- This option would ensure a fair market for all the players: Romanian credit institutions, European credit institutions

Social impact

- This option is the least likely to exclude socially disadvantaged individuals.

IV. Option 3 – Bring amendments to Norms no. 10 / 2005 in order to keep uniform limits at the level of all financial institutions, but at the same time, adjusted to different categories of consumers (incomes)

Costs for regulated banks

Option 3 would have not been significantly different from Option 1

Benefits for regulated banks

No estimation provided.

Market impact

- Quality of products offered:
    - ❖ Banks, Consumers: low
- Variety of products:
    - ❖ Banks, Consumers: medium
- Efficiency of competition:
    - ❖ Consumers: low

Costs to consumers:

- ❖ Consumers with low monthly income would have had very limited access to loans or no access at all
- ❖ The quasi-monetary incomes like meal tickets are not considered as a part of the monthly income, even if these instruments are fully regulated

Benefits to consumers:

- ❖ For some categories of consumers the access to lending could be improved
- ❖ More protection for consumers against over-indebtedness.

Impact on competition

- ❖ All the non Romanian banks (branches of foreign banks) will not be legally bound to observe the NBR regulations, and will grant loans according to their mother bank risk policy. Competition on the market affected.

Social Impact

- Depends on the limits imposed by the new regulation.

Further impacts not considered

- Depends on the limits imposed by the new regulation.

GENERAL CONCLUSIONS:

- Regulation no. 3 is not considered the best option for stakeholders' interests.
- The NBR validation will improve credit quality.
- The new norms validated by the NBR will improve de portfolio of clients (mid to high monthly income clients).